STATE OF CONNECTICUT

AUDITORS' REPORT
OFFICE OF THE STATE COMPTROLLER
STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

AUDITORS OF PUBLIC ACCOUNTS
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

Table of Contents

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July 25, 2011

AUDITORS' REPORT
OFFICE OF THE STATE COMPTROLLER - STATE FINANCIAL OPERATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2010

We have examined the records of the Comptroller of the State of Connecticut as they pertain to the central accounting of state financial operations, on a budgetary basis of accounting, for the fiscal year ended June 30, 2010. The audit certification on the Comptroller's civil list financial statements, the audited civil list financial statements themselves, and the related auditors' report on compliance and internal control over civil list financial reporting are included in a separate report entitled *Annual Report of the State Comptroller – Budgetary Basis*, for the fiscal year ended June 30, 2010. Throughout this report, we will refer to various financial statements and schedules contained in this annual report, which is hereinafter referred to as the Comptroller's 2010 Annual Report.

We have also examined the records of the Comptroller of the State of Connecticut as they pertain to the State of Connecticut's financial position and results of operations on the basis of generally accepted accounting principles. The audit certification on the financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, the aggregate remaining fund information and the respective budgetary comparison for the General Fund and the Transportation Fund, and the respective changes in financial position and cash flows, where applicable, of the State of Connecticut, which collectively comprise the state's basic financial statements are included in a separate report entitled *Comprehensive Annual Financial Report* (CAFR) as of and for the year ended June 30, 2010.

This report consists of the Comments and Recommendations, which follow. This report contains an explanation of the difference between the two reports and includes certain findings pertaining to those reports and with the internal controls and procedures applied to the state's financial reporting.

COMMENTS

OFFICERS:

Nancy S. Wyman and Mark E. Ojakian served as State Comptroller and Deputy Comptroller, respectively, during the 2009-2010 fiscal year, and until January 5, 2011. Currently, Kevin Lembo and Martha Carlson, serve as State Comptroller and Deputy Comptroller, respectively.

BUDGETARY BASIS REPORT:

The Comptroller's 2010 Annual Report covers the financial operations of the 2009-2010 fiscal year under a biennial budget adopted by the 2009 General Assembly, as revised by the 2010 General Assembly including the financial accounting for the budget plans of the General Fund and Special Transportation Fund, as it applies to the 2009-2010 audit period.

The financial position as of June 30, 2010, and the 2009-2010 cash transactions of all state civil list funds, accounted for centrally in the records of both the Office of the State Comptroller and State Treasurer, are shown in Exhibit A and Schedule A-1, respectively, of the Comptroller's 2010 Annual Report. The financial position of the General Fund at June 30, 2010, together with a summary of operations for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2010 Annual Report. Corresponding statements for the Special Transportation Fund are shown in Schedules C-2 and C-3, respectively, of the Comptroller's 2010 Annual Report. A summary of state bonds and notes outstanding as of June 30, 2010, the changes thereto, and the authorizations for future borrowings are shown in Schedules E-3, E-4, and E-5 of the Comptroller's 2010 Annual Report.

The Comptroller prepares the financial statements of the state's civil list funds on a modified cash basis of accounting, consistent with the prior year. The accounting basis used by the State of Connecticut was adopted by the Comptroller under the authority granted by Article Fourth, Section 24, of the Constitution of the State of Connecticut and with the recognition of legislative authorizations. The modified cash basis of accounting permits an accrual of revenues at fiscal year end which includes the collections in July of Indian gaming payments and certain taxes levied as of June 30, and requires that expenditures be recorded in the year in which disbursements are made, provided recognition is given to continuing appropriations.

Those taxes for which July collections are accrued include sales and use taxes, corporation taxes, gross earnings taxes on utility and petroleum companies, real estate conveyance taxes and taxes on alcoholic beverages, cigarettes, gasoline and special motor fuels. As provided by various subsections of Section 3-114 of the General Statutes, these taxes are accrued if received by the Commissioner of Revenue Services not later than five business days following the last day of July.

Under the modified cash basis of accounting used by the Comptroller, restricted revenues of the General and Special Transportation Funds are recognized when earned through the expenditure of grant funds, rather than when received or awarded. Receivables which are reported by the Comptroller include federal and other grants receivable recorded in connection with federally supported programs or capital projects for which federal or other outside participation is available, loans and notes receivable from local governments, nonprofit corporations, businesses or individuals and the accounts receivable of the University of Connecticut Health Center. Such receivables have been reported by the Comptroller as assets of the funds financing the projects or programs involved and are fully reserved on the balance sheet, except within the Grants and Restricted Accounts Fund and the Transportation Grants and Restricted Accounts Fund where the federal and other grants receivable are the source of financing for restricted appropriations established for the purposes of the grants involved. These restricted revenues are recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. In addition, interest income of the Special Transportation Fund is accrued at fiscal year end pursuant to the terms of a Special Tax Obligations Bond Indenture dated September 15, 1984.

In maintaining state accounting records and in preparing financial statements, the Comptroller, consistent with prior years, was guided by the aforementioned requirements and authorizations of state fiscal statutes as regards the method of accounting and fund classification. For this reason, therefore, the financial statements contained in the *Annual Report of the State Comptroller - Budgetary Basis* are not, nor are they intended to be, in accordance with generally accepted accounting principles (GAAP). In order for the Comptroller to follow such principles, among other things, expenditures would have to be recorded on an accrual rather than cash basis, all non-civil list funds and component units of the state would have to be included in the financial statements, all agencies' assets and contingent and long term liabilities would have to be recognized, and appropriate footnote disclosures would have to be made in the financial statements.

The use of the modified cash basis of accounting for the budgetary basis report has inherent weaknesses in that all financial activity for the fiscal year is not being accounted for within that fiscal year. Under the modified cash basis of accounting, revenues are not being recognized when they are measurable and available for use in the fiscal period, and expenditures are not being recognized as soon as they create a demand on current financial resources (when the liability is incurred). This results in reported financial performance being based on the timing of cash inflows or outflows. The timing of these transactions is set by statute or by management.

In March 2005, the American Institute of Certified Public Accountants issued an interpretation of its professional auditing standards that affects those governments that prepare financial statements using the cash, or modified cash basis of accounting, rather than reporting their financial activity in accordance with GAAP. As a result, those statements must conform to the applicable disclosure requirements of GAAP in order to avoid receiving an adverse audit opinion. This would require management to prepare and incorporate a management discussion and analysis, notes to the financial statements, and disclosure of infrastructure assets into the budgetary basis report. Because the Office of the State Comptroller has not done such, we have been required to render such an opinion on the *Annual Report of the State Comptroller - Budgetary Basis* for the fiscal year ending June 30, 2010.

COMPREHENSIVE ANNUAL FINANCIAL REPORT:

In order to comply with GAAP, the Office of the State Comptroller has issued a separate *Comprehensive Annual Financial Report* showing the State of Connecticut's financial position and results of operations in accordance with GAAP requirements. It has done so since the fiscal year ended June 30, 1988. This report, however, was always issued in addition to the *Annual Report of the Office of the State Comptroller - Budgetary Basis*, which presents the state's financial operations as budgeted by the General Assembly. Because differing accounting bases are followed in preparing the two reports, substantial variances can occur in the presentation of the state's financial position as well as its operations. The CAFR uses the modified accrual basis of accounting for all governmental activities, and the full accrual basis for business type activities. Under the modified accrual basis, revenues are recognized when they are both measurable and available to finance expenditures of the fiscal period. Expenditures for each agency are recognized in the period in which a transaction creates a demand on current financial resources, as compared to when cash is disbursed in the modified cash basis.

As explained above, the Office of the State Comptroller is required by statute to follow a practice of recording the accrual of certain revenues, notably income and corporation tax payments, without a corresponding accrual of expenditures in the General Fund. This accounting practice resulted in the accrual of more than $390,000,000 in revenues, which under a cash basis system of accounting, would be recorded in the 2010-2011 fiscal year. If there had been a similar accrual of expenditures as required by GAAP, there would have been added to General Fund liabilities salaries and fringe benefits payable and accounts payable that are estimated to be as high as $2,181,000,000 over the modified cash basis of accounting during the first year only of any conversion to GAAP budgeting by the state.

As also explained above, grant receivables are recorded as revenues when earned through the expenditure of grant funds. If there had been a similar accrual of grant receivables and accounts receivable as required by GAAP, these expenditure accruals would be offset by additional revenue and receivable accruals totaling $888,000,000 under GAAP. The net result of these effects is an estimated deficit in the Unreserved Fund Balance of the General Fund (GAAP Basis) totaling $1,679,000,000 as of June 30, 2010. This is compared to an estimated deficit totaling $2,303,400,000 as of June 30, 2009. The significant year-to-year decrease in the GAAP basis estimated deficit was largely the effect of the $947,600,000 budgetary basis deficit as of June 30, 2009. A schedule illustrating these differences, with a comparison to the previous fiscal year, is presented below:

Nearest Thousand Dollars	June 30, 2009	June 30, 2010
Unreserved Fund Balance (Deficit) -		
Modified Cash Basis	$ (947,600,000)	$ 0
Adjustments to GAAP Basis:		
Additional Assets:		
Reduction of Income Tax Accrual	(364,100,000)	(377,400,000)
Eliminate Corporation Tax Accrual	(11,200,000)	(12,600,000)
Additional Taxes Receivable	4,100,000	3,800,000
Net Accounts Receivable	199,600,000	218,000,000

Federal and Other Grants Receivable	758,500,000	645,400,000
Due From Other Funds	27,100,000	24,800,000
Total Additional Assets	$ 614,000,000	$ 502,000,000
Additional Liabilities:		
Salaries and Fringe Benefits Payable	(242,500,000)	(250,300,000)
Accounts Payable - Dept. of Social Services	(585,000,000)	(573,000,000)
Accounts Payable - All Other	(891,000,000)	(1,131,200,000)
Payable to the Federal Government	(146,100,000)	(124,500,000)
Due to Other Funds	(105,200,000)	(102,000,000)
Total Additional Liabilities	$(1,969,800,000)	$(2,181,000,000)
Unreserved Fund Balance (Deficit) - GAAP Basis	$(2,303,400,000)	$(1,679,000,000)

On the budgetary basis, General Fund annual operating expenditures exceeded annual revenues by $841 million, with the resulting deficit offset by a transfer of $1,278.5 million from the Budget Reserve Fund. After other transfers and miscellaneous adjustments, the state ended the 2009-2010 fiscal year with a surplus of $449.9 million, which was reserved for the 2010-2011 fiscal year. Accounting for the 2009-2010 fiscal year activity on a GAAP basis requires a reduction in revenue accruals totaling $155.7 million, and an increase in accounts payable and other liabilities totaling $168.7 million, resulting in a deficit in the General Fund of $1,679 million for the 2009-2010 fiscal year. As reported in the *Comprehensive Annual Financial Report*, on a government-wide basis which takes into account all non-fiduciary state assets and liabilities (all funds, in addition to the General Fund), the deficit for the 2009-2010 fiscal year totaled $9,388 million. The $3,442 million increase in the deficit was primarily caused by the expenditure of most of the accumulated balance in the Budget Reserve Fund, and by an increase in the current and non-current portions of the state's long term liabilities, including an increase in the liability for escheated property. In addition, there were increases in pension and other post retirement liabilities and a reduction in the value of capital assets, net of related debt, that are reflected in the government-wide basis used in the *Comprehensive Annual Financial Report*.

Implementation of GAAP Basis Budgeting:

For the State's *Comprehensive Annual Financial Report* to gain widespread use and acceptance, the legislative budget plan must be prepared and enacted in accordance with GAAP. In that way, the CAFR will present, in a unified format, both the budgetary and actual financial operations of the State of Connecticut. In an attempt to accomplish this end, the 1993 General Assembly passed Public Act 93-402, codified as Section 3-115b of the General Statutes. This act, effective with the fiscal year commencing July 1, 1995, authorized the Office of the State Comptroller and the Office of Policy and Management to implement the use of GAAP with respect to the preparation of the biennial budget and financial statements of the State of Connecticut. In accordance with this statute, a conversion plan was developed and submitted to the Appropriations Committee of the General Assembly in 1994. However, the plan was never implemented because the General Assembly continually postponed the state's conversion to GAAP budgeting. Through a succession of Public Acts, the original objective of implementing GAAP budgeting for the fiscal year commencing July 1, 1995, was extended by the General Assembly to the fiscal year commencing July 1, 2009.

Section 3-115b of the General Statutes was significantly revised by the passage of Public Act 08-111 during the 2008 Session of the General Assembly. Public Act 08-111, effective with the fiscal year commencing July 1, 2008, eliminated the requirements to implement GAAP and to amortize the accrued and unpaid expenses and liabilities by a certain date. Instead, it provides that …"the Comptroller, in the Comptroller's sole discretion, may initiate a process intended to result in the implementation of the use of generally accepted accounting principles, as prescribed by the Governmental Accounting Standards Board, with respect to the preparation and maintenance of the annual financial statements of the state pursuant to Section 3-115 by making incremental changes consistent with such generally accepted accounting principles." Public Act 08-111 also establishes a similar provision for the Secretary of the Office of Policy and Management with respect to the preparation of the annual budget of the state; and provides that, if the Comptroller and the Secretary of the Office of Policy and Management do decide to prepare annual conversion plans, those plans shall be submitted to the Appropriations Committee of the General Assembly.

Our current examination reviewed the progress made in preparing a conversion plan. Executive Order No. 1, signed by Governor Malloy on January 5, 2011, required the Secretary of the Office of Policy and Management to submit to the joint standing committees of Appropriations and Revenue, Finance and Bonding a written plan to bring the state into compliance with GAAP. The Office of Policy and Management, working with the Office of the State Comptroller, has prepared and submitted the required plan on April 18, 2011. Among other items, the *Plan for Conversion to GAAP Based Budgeting Developed in Accordance With Governor Dannel P. Malloy's Executive Order No. 1* recommends the revision of several state statutes, describes needed changes to the Core-CT system to facilitate the charge of accrued expenditures to prior fiscal year appropriations and the budget close/carry-forward process, employee training on proper accounting procedures, and revisions to the state's monthly and annual financial reporting. It recommends that transactional budgeting on a GAAP basis should be implemented effective July 1, 2013. The proposed biennial budget for the 2013-2014 and 2014-2015 fiscal years will be developed and implemented on a GAAP basis using the modified accrual basis of accounting and will encompass all budgeted funds. The overall form and presentation of the budget document is planned to remain largely unchanged with budgetary execution and level of control remaining the same as is currently conducted. Sections 43 to 49 of Public Act 11-48, passed during the 2011 Session of the General Assembly, contained the legislative changes proposed in the GAAP conversion plan.

The Governor's proposed biennial budget for the 2011-2012 and 2012-2013 fiscal years contains a reserve each year to help ensure that those budgets will remain balanced on a GAAP basis when year-end GAAP adjustments are made. The GAAP conversion plan recommends a one-time credit to expenditures in the 2013-2014 fiscal year that would be proportionate to the expenditures accrued in the 2012-2013 fiscal year under GAAP. This credit is intended to cover the accrued liabilities at the end of the 2013-2014 fiscal year, which being the initial year of GAAP budgeting, will be affected by the shift in timing of expenditures to the appropriate fiscal year. The plan requires the state to begin to amortize the $1.5 billion accumulated GAAP deficit beginning with the 2013-2014 budget and continuing for a total of 15 years, similar to the 1994 legislation. The annual amortization requirement is being shown in the budget in its own category as Other Requirements. This method will account for the revenue requirements for both a balanced budget and the GAAP transition amortization to be clearly identified; statutory changes will need to be made so that the appropriation for this amortization would be exempted as an expenditure, this would eliminate the effect of the amortization on the Constitutional expenditure cap.

The GAAP conversion plan provides that, if there was at the close of the fiscal year a shortfall of revenue relative to expenses, a negative unreserved balance in the balance sheet would result, illustrating a budget deficit. In addition, the following year's budget would require the sum of anticipated revenue plus the unreserved fund balance, as determined by the audited financial statements, to be equal to or greater than appropriation requirements for that fiscal year; if they did not do so, a budget deficit would be identified for that following year. Therefore, the requirements of Section 4-85 of the General Statutes requiring that the Governor propose measures to bring the budget back into balance should a General Fund deficit of more than one percent be forecast would be, in effect, requiring implementation of a deficit mitigation plan.

Technical issues with the Core-CT system represent a significant problem for GAAP-basis budgeting. In the Core-CT system, open purchase orders for prior year expenditures are rolled into the following fiscal year. The purchase order is closed when the expenditure is processed. Under GAAP accounting, prior year purchases must be charged back to the prior fiscal year, and sufficient funds must be encumbered from the old year budget to cover those payments. Under one method proposed in the GAAP conversion plan, state agencies themselves will be required to determine which purchase orders must remain in the old fiscal year, and which are to be rolled forward. Under this decentralized method, it is essential that state agencies properly assign the correct accounting dates to vouchers posted to the Core-CT system so that the proper accounting period is charged. Similar issues are found to affect revenue accounting. Deposits made in July and August earned in the prior fiscal year must be posted with that year's accounting date. Data systems at the Department of Revenue Services and at other state agencies must be able to identify the tax period or other determining date in order to apply correct accruals. The GAAP conversion plan recommends training for agency employees so that this assignment is properly administered. Using this method would also require effective internal controls to ensure the decentralization of the accounting date entry function does not result in either deliberate or inadvertent postings with the wrong date. In addition, modifications to the Core-CT system are recommended so that commitment control (budget compliance) is exercised over transactions prior to expenses being incurred on a GAAP basis.

We note an additional complication to implementing GAAP-based budgeting is caused by the failure in the initial implementation to adopt the Core-CT system completely across all state agencies. Currently, the University of Connecticut, the University Health Center, the Connecticut State University, the Connecticut Community Colleges, the Office of Legislative Management and the Judicial Department are allowed to operate as 'limited scope' Core-CT agencies. These agencies process their transactions through their own accounting systems and will then periodically enter the information into the Core-CT system. This presents problems in maintaining compliant accounting dates, calculating accruals on-line, and obtaining the most current on-line information. Consideration has been made to require all state agencies to operate under the Core-CT system. However, there are significant costs and difficulties involved.

Financial Reporting Under GAAP Basis Budgeting:

The GAAP conversion plan anticipates that the biennial budget for the 2013-2015 fiscal years will be prepared and approved on a GAAP basis. Under GAAP-based budgeting, the Comptroller's financial reporting will, starting on July 1, 2013, consist of:

1. Cumulative monthly statements that present revenues and expenditures to date for the General Fund and Special Transportation Fund. These statements will reflect revenues and expenditures on a GAAP basis as provided by the Office of Policy and Management. They also will include a statement of estimated revenue by source to the end of the fiscal year and a statement of appropriation requirements to the end of the fiscal year that will correspond to the budget act. During the transition period for the 2012 and 2013 fiscal years, the monthly statements will be on a budgetary basis with additional information included to provide an estimate on the adjustments necessary to convert the operating results to the GAAP basis.
2. Unaudited annual financial statements to be issued by September 30th for all budgeted funds, on a GAAP basis. These will include a statement of all appropriations and expenditures for the fiscal year itemized by each appropriation account of each budgeted agency; a statement of the revenues of the state classified as far as practicable as to budgeted agencies, sources and funds during such year; a statement setting forth the total tax receipts of the state during such year; and a balance sheet as of the close of the fiscal year. This will replace the report to the Governor that is statutorily required by September 1st of each year. For the purpose of preparing the next year's budget, and for certifying the surplus or deficit for the budgeted funds, an audited set of these statements will be made available by December 31st of that year.
3. The current *Comprehensive Annual Financial Report*, which will be supplemented by a detailed schedule of appropriations and expenditures by agency that will correspond with the budget act. The *Comprehensive Annual Financial Report* includes an auditor's report and discloses statewide activity on a GAAP basis, including all funds, the component units, a management discussion and analysis, notes to the financial statements, and the disclosure of fixed assets, pension liabilities and statistical information. In accordance with Securities and Exchange Commission continuing disclosure requirements, this report is required to be made available by February 28th of the following year. The current *Report of the Office of the State Comptroller - Budgetary Basis*, issued on December 31st, will be eliminated. This will eliminate the publication of two sets of published annual financial reports, one for each basis of accounting, which was considered the use of 'two sets of books' by the State of Connecticut. It will result in clarified financial reporting.

The State of Connecticut uses fund accounting that places all related assets, liabilities and residual equity within a single self balancing set of accounts to ensure and demonstrate fiscal accountability and legal compliance. The following is a summary of activity for the state's major funds and fund groups, on the budgetary basis, for the 2009-2010 fiscal year. However, as noted above, only a government-wide focus of reporting, as used in the CAFR, properly demonstrates a government's overall financial condition.

GENERAL FUND:

The General Fund is the chief operating fund of the state. It is used to account for all financial resources which are not required to be accounted for in other funds and which are spent for those services normally provided by the state.

The financial position of the General Fund, on a budgetary basis at June 30, 2010, together with a summary of operations recorded for the year then ended, are shown in Exhibit B and Schedule B-1, respectively, of the Comptroller's 2010 Annual Report.

General Fund operations were conducted under a biennial budget plan, which estimated revenues and provided for expenditures of the 2009-2010 and 2010-2011 fiscal years. Public Act 09-3, the budget act, included revenue estimates and appropriations for the 2009-2010 and 2010-2011 fiscal years and revenue estimates of the General Assembly's Committee on Finance, Revenue and Bonding. The budget was enacted by the June Special Session of the 2009 General Assembly. It was passed August 31, 2009 and became law September 9, 2009, two months after the fiscal year began and without the Governor's signature. The budget act included the transfer of $1,062,100,000 from the Budget Reserve Fund to the General Fund, $72,000,000 from the General Fund to the Special Transportation Fund, $57,175,000 from various special funds and accounts to the General Fund, and carried forward $88,771,000 in various unspent General Fund appropriations from the 2008-2009 fiscal year to the 2009-2010 fiscal year.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period, after consideration of any statutorily required transfers, give rise to an anticipated surplus or deficit projected through the end of the fiscal year. The budget plan for the 2009-2010 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2009-2010, as Revised by the Committee on Finance, Revenue and Bonding		$17,372,400,000
Budgeted Appropriations, 2009-2010	$17,843,614,330	
Estimated lapsing appropriations	(473,293,794)	
Net Appropriations		17,370,320,536
Anticipated Surplus (Deficit), June 30, 2010		**$ 2,079,464**

Minor changes were made in the 2009-2010 budget by the passage of a set of implementer bills during the September Special Session of the 2009 General Assembly. Minor changes were made in the budgets for general government, human services and education by the passage of Public Acts 09-5, 09-6, and 09-7 during the September Special Session of the General Assembly. In addition, Public Act 09-3 made minor changes in the budget for public health, eliminated the malpractice fund at the University of Connecticut Health Center and transferred $10,000,000 of its balance to the General Fund for the 2009-2010 fiscal year. Public Act 09-8 made minor changes to certain taxes and fees. It also reduced the transfer from the Budget Reserve Fund to the General Fund and from the General Fund to the Special Transportation Fund to $1,039,700,000 and $62,800,000, respectively.

The 2009-2010 budget was subsequently revised by Public Act 10-3, passed by the 2010 General Assembly and signed by the Governor on April 14, 2010. In accordance with Section 4-85 of the General Statutes, if the cumulative monthly financial statement issued by the Comptroller pursuant to section 3-115 includes a projected General Fund deficit greater than one per cent of the total of General Fund appropriations, the Governor, within thirty days following the issuance of such statement, shall file a report with such joint standing committees, including a plan to modify such allotments to the extent necessary to prevent a deficit. Public Act 10-3 was a deficit mitigation plan that reduced General Fund appropriations by $77,597,665 for various agencies and programs, transferred funds from various special funds and accounts to the General Fund and made adjustments to medical assistance and social service programs. It also increased the transfer from the Budget Reserve Fund to the General Fund to $1,278,474,880.

Specific agency deficiencies were addressed by Public Act 10-179, passed by the 2010 General Assembly and signed by the Governor May 7, 2010. It reduced General Fund appropriations in various agencies by $75,000,000, with an offsetting increase in appropriations, primarily for Medicaid. In addition to the deficiency funding provided in the Public Act, holdbacks totaling $91,400,000 for various agencies were released to address shortfalls that would have otherwise required deficiency funding.

The actual results of the operations of the 2009-2010 fiscal year are presented in Schedule B-1 of the Comptroller's 2010 Annual Report. We have previously described the differences between the resulting financial operations by accounting on the budgetary basis as compared to the GAAP basis. An analysis of budgeted General Fund accounts follows:

Actual Budgeted Revenues, 2009-2010		$17,688,528,583
Appropriations, 2009-2010	$17,890,006,416	
Add/(Deduct)		
Appropriations lapsed	(560,510,197)	
Net Appropriations		17,329,496,219
Balance		359,032,364
Prior Year Budgeted Appropriations		
Continued to 2009-2010 Fiscal Year		88,771,530
Miscellaneous adjustments		2,064,694
Surplus (Deficit)		449,868,589
Reserve for 2010-2011 Fiscal Year		(449,868,589)
Unappropriated Surplus, June 30, 2010,		
per Schedule B-1		**$ 0**

The variances between the actual results of operations and the original budget plan may be explained as follows:

1. *Actual revenues were some $316,129,000 greater than originally estimated. Those revenue categories that showed the greatest increase were rents, fines and escheats, $155,492,000, and transfers to the General Fund $282,948,000. The increase in revenues was partly offset by a decrease of $54,468,000 in corporation taxes, $44,601,000 in personal income taxes, and $65,090,000 in miscellaneous revenues.*

2. *Appropriations showed an increase of approximately $46,392,000 from the budget plan reported by the Comptroller. The increase was primarily from $88,771,530 in prior year appropriations carried forward to the succeeding fiscal year, net against a total of $42,379,000 in appropriation adjustments.*

3. *Lapsed appropriations were some $87,216,000 greater than estimated, the result of an effort to reduce general state expenditures.*

A statement of changes in the unappropriated surplus account of the General Fund for the fiscal year ended June 30, 2010, is presented in Schedule B-1 of the Comptroller's 2010 Annual Report. It should be noted that Section 4-30a of the General Statutes provides that the unappropriated surplus that remains in the General Fund at the end of the fiscal year, after any amounts required by law to be transferred for other purposes have been deducted, shall be deposited to the Budget Reserve Fund (12056), provided that the amount so transferred shall not cause the balance in such fund to exceed ten percent of the net General Fund appropriations for the fiscal year in progress. At the close of the fiscal year ended June 30, 2010, the balance in the Budget Reserve Fund totaled $103,273,466. For the fiscal year ended June 30, 2010, there was no surplus transferred to the Budget Reserve Fund at the close of the fiscal year. In accordance with Public Act 10-179, any unappropriated surplus in the 2009-2010 fiscal year is to be transferred to the 2010-2011 fiscal year.

General Fund Revenues:

Realized budgeted revenues in the General Fund for the 2009-2010 fiscal year totaled $17,688,528,583, as shown in Schedule B-1 of the Comptroller's 2010 Annual Report. This represented a increase in revenues of $1,987,727,699 as compared to the budgeted revenue total reported by the Comptroller for the preceding 2008-2009 fiscal year.

The budgeted revenue categories which showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Personal income	$ 200,242,000
Sales and use	(114,765,000)
Corporations	51,212,000
Cigarettes and Tobacco	69,661,000
Insurance companies	24,332,000
Real Estate Conveyance	9,465,000
Inheritance and Estate	(60,736,000)
Oil companies	18,605,000
Alcoholic Beverages	1,132,000
All others (net)	(4,132,000)
Refunds of Taxes - increase	(9,147,000)
Total Increase (Decrease) in Taxes	185,869,000

Other Revenues and Sources:	
Indian gaming payments	6,443,000
Licenses, permits and fees	95,095,000
Rents, fines and escheats	188,774,000
Investment income	(14,744,000)
Miscellaneous	(17,399,000)
Federal grants	446,824,000
Statutory transfers to/from other funds - net	1,096,866,000
Total Increase (Decrease) in Other Revenues and Sources	1,801,859,000
Total Increases (Decreases)	**$ 1,987,728,000**

The increases in income, business and other taxes were attributed to statutory changes in tax rates enacted by the 2009 General Assembly in Public Act 09-3 of the June Special Session. Public Act 09-3 increased the threshold of the gift and estate tax from $2,000,000 to $3,500,000. In addition, there were statutory changes in the amounts charged for licenses, permits and in fees. The decline in sales and use tax was the result of economic conditions during the year. The increase in federal grants was primarily from the federal American Recovery and Reinvestment Act (ARRA) of 2009. The most significant factor in the increase of reported revenues was the transfer of monies from the Budget Reserve Fund to the General Fund.

General Fund Expenditures:

Total budgeted expenditures of the General Fund for the 2009-2010 fiscal year amounted to $17,208,020,984, as shown in Schedule B-1 of the Comptroller's 2010 Annual Report. This latter amount represented an decrease of some $26,833,900 over the total budgeted expenditures reported by the Comptroller for the preceding 2008-2009 fiscal year. General Fund expenditures classified by current expenses, fixed charges and capital outlay are detailed on Schedule I of the Comptroller's 2010 Annual Report. A summary of the areas of significant changes in expenditures from budgeted accounts of the General Fund follows:

	Nearest Thousand Dollars
Personal Services	$ (188,487,000)
Other Current Expenses:	
University of Connecticut Health Center – Operating Expenses	(10,478,000)
State Employees' Social Security Contributions	(10,745,000)
Pension Obligation Bonds – Teachers' Retirement	58,451,000
Judges' and Compensation Commissioners' Retirement	(14,172,000)
State Employees Retirement Contributions	23,321,000
Retired State Employees Health Service Cost	93,312,000
Department of Administrative Services	11,880,000
All Other - primarily contractual services and commodities	(76,949,000)
Fixed Charges:	
Debt Service	89,307,000
Information Technology – Statewide Information Technology	20,909,000

Environmental Protection – environmental conservation and quality, emergency spill response and underground storage tank	32,663,000
State Aid Grants:	
Policy and Management – primarily energy assistance grants	(23,028,000)
Developmental Services – voluntary services, employment opportunities and community residential services	27,551,000
Public Health – various programs	(11,184,000)
Culture and Tourism – various grants	(10,764,000)
Children and Families – board and care for children	(9,078,000)
Children's Trust Fund	(11,005,000)
All Other Fixed Charges	(15,100,000)
Capital Outlay	(3,238,000)
Total Net Increase	**$ (26,834,000)**

Reduced costs for personal services, contractual services, commodities and various grant programs accounted for the majority of the decrease. They were partially offset by increases in debt service and the funding of pension and retiree health care obligations.

SPECIAL TRANSPORTATION FUND:

The Special Transportation Fund operates in accordance with the provisions of Title 13b, Chapter 243, Part I, of the General Statutes. The Special Transportation Fund was established in 1984 as part of a continuous program of planning, construction and improvement of the state's transportation infrastructure. Such infrastructure includes the state's highways and bridges, the state's share of the local bridge program, mass transportation and transit facilities, waterway and aeronautic facilities other than Bradley International Airport, and maintenance garages and administrative facilities of the Department of Transportation.

The Special Transportation Fund is used for the purpose of budgeting and accounting for all transportation-related taxes, fees and revenues that are used to secure the payment of debt service on Transportation Infrastructure bonds which are issued in accordance with the provisions of Chapter 243, Part II, of the General Statutes, as special tax obligation bonds. After providing for such debt service, the balance of the resources of the fund are available for the payment of debt service on other transportation-related bonds issued by the state, and for the funding of appropriations for the Department of Transportation and the Department of Motor Vehicles.

Revenues credited to the Special Transportation Fund are, among other items, certain motor fuel taxes, portions of the oil companies tax and the sales tax on motor vehicles, motor vehicle receipts for licenses, registrations and titles, fees for safety marker plates, motor vehicle related fines and penalties, transportation-related federal aid, late fees for the emission inspection of motor vehicles, and revenues from the sale of information by the Department of Motor Vehicles.

The financial position of the Special Transportation Fund as of June 30, 2010, excluding those resources held by the trustee under the Indenture of Trust for the Transportation Infrastructure special tax obligation bonds, on a budgetary basis, is presented in Schedule C-2 of the Comptroller's 2010 Annual Report. A statement of the changes in unappropriated surplus of the fund for the fiscal year then ended is shown in Schedule C-3. It should be noted that cash and investments totaling $687,751,545, which are being held by the trustee, are reported on Exhibit A of the Comptroller's 2010 Annual Report under Debt Service Funds.

Special Transportation Fund operations, like the General Fund, were conducted under a biennial budget plan, Public Act 09-3, the budget act for the Special Transportation Fund enacted by the June Special Session of the 2009 General Assembly, and included revenue estimates and appropriations for the 2009-2010 and 2010-2011 fiscal years.

Under budget procedures customarily in effect, the estimates of revenues and the budgeted appropriations, taken in conjunction with whatever surplus or deficit was carried over from the preceding fiscal period give rise to an anticipated surplus or deficit projected through the end of the fiscal year.

The budget plan for the 2009-2010 fiscal year as reported by the Comptroller may be expressed as follows:

Estimated Revenues, 2009-2010, as Revised by the Committee on Finance, Revenue and Bonding		$1,115,700,000
Budgeted Appropriations, 2009-2010	$1,135,879,421	
Estimated lapsing appropriations	(21,227,979)	
Net Appropriations		1,114,651,442
Anticipated Surplus, June 30, 2010		**$ 1,048,558**

The actual results of the operations of the 2009-2010 fiscal year are presented in Schedule C-3 of the Comptroller's 2010 Annual Report. An analysis of the Special Transportation Fund surplus follows:

Actual Budgeted Revenues, 2009-2010		$1,117,888,391
Appropriations, 2009-2010	$1,173,094,210	
Add/(Deduct)		
Appropriations lapsed	(29,674,560)	
Net Appropriations		1,143,419,650
Balance		(25,531,259)
Unappropriated Surplus, July 1, 2009		93,570,430
Prior Year Budgeted Appropriations Continued to 2009-2010 Fiscal Year		37,324,150
Miscellaneous adjustments		367
Unappropriated Surplus, June 30, 2010, per Schedule C-3		**$ 105,363,688**

The variances between the actual results of operations and the original budget plan may be explained as follows:

1. *Actual revenues were some $2,188,000 greater than anticipated. This was primarily the result of a increase of $8,935,000 in motor fuels taxes and an increase of $12,984,000 in sales tax collections. It was offset by a decline of $3,797,000 in miscellaneous receipts, a decline of $9,818,000 in interest income, and a $7,000,000 reduction in the net amount transferred to and from other funds.*

2. *Appropriations showed an increase of approximately $37,215,000 from the budget plan reported by the Comptroller. This was the direct result of $37,324,150 in appropriations carried forward from the previous fiscal year.*

3. *Lapsed appropriations were some $8,447,000 greater than estimated, primarily from an effort to reduce general state expenditures.*

Special Transportation Fund Revenues:

Realized budgeted revenues in the 2009-2010 fiscal year for the Special Transportation Fund totaled $1,117,888,391, as shown in Schedule C-3 of the Comptroller's 2010 Annual Report. This represented an increase of some $85,184,256 over the budgeted revenue total reported by the Comptroller for the preceding 2008-2009 fiscal year. Budgeted revenue categories which showed the greatest change during the fiscal year under audit were as follows:

	Nearest Thousand Dollars
Taxes:	
Motor Fuels Tax	$ 8,611,000
Sales Tax – Collected at the Department of Motor Vehicles	10,650,000
Other Revenues:	
Licenses, permits and fees	(7,427,000)
Interest income	(8,902,000)
Transfers from Other Funds	71,200,000
Transfers to Other Funds	9,492,000
All other taxes and other revenue	1,560,000
Total Net Increase (Decrease)	**$ 85,184,000**

The above increase was primarily attributable to an increase in the collection of motor fuels tax, sales tax, and transfers from other funds. It was offset by decreases in collections for licenses, permits and fees, and interest income.

Special Transportation Fund Expenditures:

Total budgeted expenditures of the Special Transportation Fund for the 2009-2010 fiscal year amounted to $1,101,442,615, as shown in Schedule C-5 of the Comptroller's 2010 Annual Report. This represented a decrease of some $26,758,916 from the total budgeted expenditures reported by the Comptroller for the preceding 2008-2009 fiscal year. A summary of the areas of significant changes in expenditures from budgeted accounts of the Special Transportation Fund follows:

	Nearest Thousand Dollars
Department of Motor Vehicles – personal services and other expenses	$ (5,048,000)
Department of Transportation:	
Personal services and other expenses	(9,364,000)
Equipment	(5,472,000)
Rail operations	9,475,000
Bus operations	8,713,000
Town Aid Road Grants	(30,000,000)
Office of the State Comptroller:	
Debt Service	2,873,000
All other (net)	2,064,000
Total Net Increase (Decrease)	**$ (26,759,000)**

The above decrease in expenditures was primarily attributable to decreases in personal services costs at the Department of Motor Vehicles and the Department of Transportation, and decreases in Town Aid Road grants.

SPECIAL REVENUE FUNDS:

This category of funds was established to group those funds accounting for the expenditure of revenues that have been restricted to specific programs. Included in this category is the Special Transportation Fund. However, because of the size and importance of this fund, it has been incorporated into this report under a separate heading preceding this section.

The financial position of the combined Special Revenue Funds at June 30, 2010, on a budgetary basis, together with the cash transactions for the fiscal year ended on that date, are shown in Exhibit C and Schedule C-1, respectively, of the Comptroller’s 2010 Annual Report. As of June 30, 2010, there were 56 authorized funds within this category, with the Special Transportation Fund the largest by far. Of these 56 funds, the following nine funds operate under legislatively enacted budget plans:

- Special Transportation Fund (12001)
- Banking Fund (12003)
- Insurance Fund (12004)
- Consumer Counsel and Public Utility Control Fund (12006)
- Workers’ Compensation Administration Fund (12007)
- Mashantucket Pequot and Mohegan Fund (12010)
- Soldiers’, Sailors’ and Marines’ Fund (12010)
- Regional Market Operation Fund (12013)
- Criminal Injuries Compensation Fund (12014)

Grants and Restricted Accounts Fund:

The Grants and Restricted Accounts Fund (12060), was established to account for certain federal and other revenues associated with activities of the General Fund, primarily federal grant assistance.

Receipts and transfers amounting to $1,947,804,642 for the 2009-2010 fiscal year were credited to the fund, as shown on Schedule C-1 of the Comptroller's 2010 Annual Report. These represented federal and other grant receipts, restricted and not available for general use. As mentioned previously in this report, such restricted revenue is recognized by the Comptroller when earned through the expenditure of grant funds, rather than when received or awarded. Receipts and transfers increased by some $184,310,515, as compared to the total reported by the Comptroller in the preceding 2008-2009 fiscal year. The increase in receipts and transfers, as compared to the preceding fiscal year, was primarily from increased federal grant receipts.

Disbursements of federal and other grants from the Grants and Restricted Accounts Fund for the 2009-2010 fiscal year amounted to $1,941,456,803, as shown in Schedule C-1 of the Comptroller's 2010 Annual Report. This represented an increase of some $177,962,676 over the total reported by the Comptroller for the preceding 2008-2009 fiscal year.

Transportation Grants and Restricted Accounts Fund:

The Transportation Grants and Restricted Accounts Fund (12062), was established to account for certain restricted federal and other revenues associated with activities of the Special Transportation Fund, primarily federal grant assistance related to highway and transit projects.

Receipts and transfers amounting to $736,344,852 for the 2009-2010 fiscal year were credited to the Transportation Grants and Restricted Accounts Fund, as shown on Schedule C-1 of the Comptroller's 2010 Annual Report. This represented an increase of some $62,666,012 over the total reported by the Comptroller for the preceding 2008-2009 fiscal year. For the purpose of construction of any highway or bridge, the Office of the State Comptroller is authorized under the provisions of Section 13a-166 of the General Statutes to record as a receivable that portion of a federal grant apportionment for the financing of the federal share of highway projects approved by the Federal Highway Administration, and such amounts are deemed to be appropriated for said purposes.

Disbursements of federal and other grants from the Transportation Grants and Restricted Accounts Fund for the 2009-2010 fiscal year amounted to $794,161,689, as shown in Schedule C-1 of the Comptroller's 2010 Annual Report. This represented an increase of some $154,753,153 over the total reported by the Comptroller for the preceding 2008-2009 fiscal year.

Additional comments concerning the operations of an individual Special Revenue Fund will be found in audit reports covering the various state agencies administering or using such funds.

DEBT SERVICE FUNDS:

This category of funds was established to account for the accumulation of resources for, and payment of, principal and interest on certain state issued bonds and notes. While, as a rule, the bulk of general obligation bonds of the state are liquidated from General Fund and Special Transportation Fund appropriations, most so-called self-liquidating general obligation bond issues are retired by payment from these funds.

The financial position of the combined Debt Service Funds at June 30, 2010, together with the cash transactions for the fiscal year ended on that date, on a budgetary basis, are shown in Exhibit D and Schedule D-1, respectively, of the Comptroller's 2010 Annual Report. As of June 30, 2010, there were six authorized funds within the Debt Service Funds category. The largest debt service fund, entitled "Transportation Special Tax Obligations" (14005), is used to account for cash and investments held by a trustee for debt service payments on bonds issued to finance the state's infrastructure program.

CAPITAL PROJECTS FUNDS:

This category of funds was established to group those funds that account for financial resources used to acquire or construct major capital facilities, including highways and bridges. Included in this category are additional funds authorized for capital improvements and non-capital improvements or other purposes by specific fiscal year. The most significant of these funds is the Infrastructure Improvement Fund (13033) which is used to account for highway and transit construction project expenditures at the Department of Transportation. The major source of financing for Capital Projects Funds is the proceeds of various state bond issues. Other sources include federal aid and other restricted contributions receivable to meet a portion of the capital outlay costs.

The financial positions of the combined Capital Projects Funds at June 30, 2010, and the cash transactions of the 2009-2010 fiscal year, on a budgetary basis, are set forth in Exhibit E and Schedule E-1, respectively, of the Comptroller's 2010 Annual Report. As of June 30, 2010, there were 52 authorized funds within the Capital Projects Funds category.

The total unreserved fund balances of the Capital Projects Funds decreased by $138,097,519 during the 2009-2010 fiscal year to a deficit balance of $4,345,060,691, as of June 30, 2010. It should be noted that the issuance of bonds already authorized, as shown in Schedule E-5, as well as the collection of those receivables fully reserved in Exhibit A and Exhibit E, will eliminate this deficit balance.

INTERNAL SERVICE FUNDS:

This category of funds was established to group those funds accounting for the costs and billings for goods and services provided by state agencies to other agencies or governmental units. These costs are recovered by transfer charges to user agencies so that authorized working capital of the funds is kept intact.

The financial position of the combined Internal Service Funds at June 30, 2010, together with the cash transactions for the fiscal year then ended, on a budgetary basis, are shown in Exhibit F and Schedule F-1, respectively, of the Comptroller's 2010 Annual Report. As of June 30, 2010, there were four authorized funds within the Internal Service Funds category.

Exhibit A of the Comptroller's 2010 Annual Report recognizes, as reserved within fund balances and related reserves, the allotment and appropriation balances in force as of June 30, 2010, and which have been carried forward to the 2010-2011 fiscal year on the records of the Office of the State Comptroller. This has resulted in additional deficit unreserved fund balances being reported in Exhibit A and Exhibit F of the Comptroller's 2010 Annual Report because the assets and resources to meet these allotment balances are already reserved or, more likely, are not recorded by the Comptroller. Those assets and resources not recorded include inventories and receivables reported only by the agencies administering the funds involved.

Additional comments concerning the operations of each individual Internal Service Fund will be contained in audit reports covering the various state agencies administering such funds.

ENTERPRISE FUNDS:

This category of funds was established to group those proprietary funds that provide for the financing of goods and services to the public and recover costs by user charges.

The financial position and fiscal year cash transactions of the combined Enterprise Funds, as accounted for in the records of the Office of the State Comptroller, on a budgetary basis, are shown in Exhibit G and Schedule G-1, respectively, of the Comptroller's 2010 Annual Report. As of June 30, 2010, there were 20 authorized funds within the Enterprise Funds category. Additional comments concerning the operations of each individual Enterprise Fund will be contained in audit reports covering the various state agencies administering such funds.

FIDUCIARY FUNDS:

The financial position of the combined Fiduciary Funds at June 30, 2010, and the cash transactions for the year then ended, on a budgetary basis, is shown in Exhibit H and Schedule H-1, respectively of the Comptroller's 2010 Annual Report. The funds included under this caption may be classified into three types:

- Receipts held pending distribution to state funds, municipalities, private companies or individuals.
- Deposits held by the state for security, guarantees, awards, endowments or distributions.
- Retirement and post employment benefit funds for state and municipal employees held in trust by the State Treasurer.

As of June 30, 2010, there were 37 authorized funds within the Fiduciary Funds category. The total liabilities, reserves and fund balances of the Fiduciary Funds increased by $5,278,158,299 during the 2009-2010 fiscal year to a balance of $38,305,500,483, as of June 30, 2010. The increase was primarily the result of the recorded increase in resources to be provided to meet pension actuarial deficiencies. The amounts reported as resources to be provided in future years for retirement funds were as of June 30, 2010, and were based on the currently available actuary reports. The Fiduciary Funds financial statements did not report actuarially determined resources to be provided in future years for other post employment benefits.

Additional comments concerning the operations of each individual Fiduciary Fund will be contained in audit reports covering the various state agencies administering or using such funds.

STATE BOND AND NOTE INDEBTEDNESS:

The state's bond and note indebtedness at June 30, 2010, payable from future revenue of state funds is shown in Exhibit A of the Comptroller's 2010 Annual Report. A summary of bonds and notes outstanding and maturity schedules, detailing the funding requirements of specific bond and note issues, are presented in Schedule E-3 and Schedule E-4, respectively, of the Comptroller's 2010 Annual Report.

The state's bond and note indebtedness aggregated $19,206,065,000 as of June 30, 2010, an increase of $1,286,156,000 over the total of $17,919,909,000 at June 30, 2009. This was the net result of the issuance during the 2009-2010 fiscal year of new bonds of the state in the amount of $2,209,600,000, and economic recovery notes of $915,795,000, while scheduled principal payments and refunded and defeased bonds during the period amounted to $1,839,239,000. Scheduled interest costs through maturity on the aforementioned bond and note indebtedness, as shown in Schedule E-4 of the Comptroller's 2010 Annual Report, totaled $8,302,245,000. Accordingly, as of June 30, 2010, the state was committed to future debt service on bonds and notes outstanding in the aggregate of $26,011,270,000. This total represented an increase of $346,359,000 over the corresponding amount as of June 30, 2009.

Included in the totals of bond and note indebtedness are revenue and refunding bonds outstanding in the amount of $231,790,000 for improvements to Bradley International Airport. The proceeds of such bonds are being held and disbursed by a trustee and all revenue of the airport's operations is being deposited with the trustee. Principal and interest payments on such bonds are being met from funds held by the trustee. Similarly, included in the totals of bond and note indebtedness are the revenue bonds outstanding of $3,030,485,000 for the state's Transportation Infrastructure Program. While the proceeds of such bonds are held and accounted for in the usual manner, debt service reserve amounts and principal and interest payments on such bonds are being handled by a trustee.

Partially offsetting the aforementioned indebtedness were unreserved fund balances of $9,411,908 within the debt service fund group, which were available for debt service at June 30, 2010, and which are detailed in Exhibit D of the Comptroller's 2010 Annual Report.

In addition to the foregoing bond indebtedness at June 30, 2010, there was in force as of that date unused borrowing authorizations totaling $3,248,572,000 and prospective authorizations, subject to Bond Commission approval, totaling $3,292,184,000. These authorization balances, which are detailed in Schedule E-5 of the Comptroller's 2010 Annual Report, may be summarized as follows:

Purpose or Agency	**In Force**	**Prospective Authorizations**
Student Loan Foundation	$ 5,000,000	$ 0
Municipal and Economic Development	124,073,000	183,730,000
Local Capital Improvements	10,000,000	20,000,000
State Equipment Purchases	26,427,000	37,350,000
Grants to Local Governments and Others	66,523,000	806,195,000
Contaminated Property Remediation	0	3,000,000
Housing Programs	26,409,000	105,148,000
Highway and Bridge Construction Repair	1,452,000	0
Magnet Schools	17,501,000	0
Preservation of Agricultural Lands	5,751,000	0
Transportation Infrastructure Improvement	1,624,780,000	1,297,421,000
University and State University Facilities	2,891,000	95,000,000
Capital Improvements and Other Purposes	256,937,000	597,136,000
Connecticut Innovations Incorporated	500,000	0
Bradley Parking Garage	0	1,200,000
Elimination of Water Pollution	531,383,000	145,004,000
Industrial Building Mortgage Insurance	19,450,000	1,000,000
Connecticut Development Authority	3,595,000	0
Second Injury Fund	525,900,000	0
Total Authorizations	**$3,248,572,000**	**$3,292,184,000**

It should be noted that, in accordance with the debt limitation provisions contained in Section 3-21 of the General Statutes, no bonds, notes, or other evidences of indebtedness for borrowed money payable from General Fund tax receipts of the state shall be authorized by the General Assembly except as shall not cause the aggregate amount of (1) the total amount of such indebtedness authorized by the General Assembly but not yet issued and (2) the total amount of such indebtedness which has been issued but remains outstanding, to exceed 1.6 times the total estimated General Fund tax receipts of the state for the fiscal year in which any such authorization will become effective, as estimated by the joint standing committee of the General Assembly having cognizance of finance, revenue and bonding. Such tax receipts for the fiscal year ended June 30, 2010 were estimated, as of February 1, 2011, to total $10,923,400,000. As of February 1, 2011, the State Treasurer determined that authorizations for bonds, notes, and other obligations subject to such limit, net of debt retirement fund resources related to certain self-liquidating bond issues, totaled $14,608,206,094. Accordingly, as of this date, the state's debt-incurring margin totaled $2,869,233,906.

In addition to the indebtedness previously mentioned, there were other obligations that, although not in the form of state bonds or notes, constituted long-term indebtedness or the guarantee of existing indebtedness. Such obligations included:

1. *Obligations of the state to towns for participation in the construction and alteration of school buildings, under Section 10-287 of the General Statutes (installment payments) in the amount of some $304,000,000, and Sections 10-287g and 10-287h (interest subsidy) in the amount of some $54,000,000, as of June 30, 2010. It should*

be noted that Sections 10-287g and 10-287h were repealed by Public Act 97-11 (June Special Session) for construction projects approved subsequent to July 1, 1997. With regard to projects approved after July 1, 1997, this same public act established a new financing method, which provides for the state to pay for its share of school construction costs on a "progress payment" basis. As of June 30, 2010, the State Board of Education estimates that current grant obligations under this latter program will total some $2,550,000,000.

2. *The obligation of Section 5-156a of the General Statutes to fund the State Employees Retirement System on an actuarial reserve basis. The unfunded actuarial liability is amortized as a level percent of payroll over a declining period of years, starting with 40 years as of July 1, 1991. A full actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $11,704,591,789.*

3. *The obligation of Section 51-49d of the General Statutes to fund the Judges, Family Support Magistrates and Compensation Commissioners Retirement System on an actuarial reserve basis over a 40-year period commencing July 1, 1991. The last actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $97,107,583.*

4. *The obligation of Section 10-183z of the General Statutes to fund the Teachers' Retirement System on an actuarial reserve basis over a 40-year period commencing July 1, 1992. The last actuarial survey of the system was performed as of June 30, 2010, and showed an unfunded accrued liability of $9,065,729,000.*

5. *Loans under the Insurance and Umbrella programs, insured by the state ($25,000,000 maximum limit) through the Connecticut Development Authority, which totaled $4,643,749 as of June 30, 2010. However, in accordance with Section 32-17a of the General Statutes, these are contingent indebtedness of the state; actual indebtedness would result only in the event of a loan default or the inability of the Authority to make the payment of bonds and notes.*

6. *Loan guarantees under the Connecticut Works Fund, insured by the state through the Connecticut Development Authority, as provided for in Section 32-23ii of the General Statutes. The state has authorized the issuance of up to $95,000,000 in bonds allocated to the fund, of which as of June 30, 2010, $82,485,000 has been distributed. Loan guarantees were also extended under the Connecticut Works Guarantee Fund, as provided for in Section 32-261 of the General Statutes. The state has authorized the issuance of up to $30,000,000 in bonds allocated to the funds, of which as of June 30, 2010, $18,900,000 has been distributed. The Connecticut Development Authority also provides portfolio insurance to participating financial institutions under the Connecticut Capital Access Fund, as provided for in Section 32-265 of the General Statutes. The state has authorized the issuance of $5,000,000 in bonds allocated for the purpose, of which $2,000,000 have been distributed. Any losses on guarantees made by the Authority under any of these funds are reimbursable by the state until the remaining bond allocation has been utilized.*

7. *The State of Connecticut is contingently liable to the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority and the Connecticut Higher Education Supplemental Loan Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain authority bonds in the event authority funds are insufficient to do so, as provided for in Sections 8-252a(b), 22a-272(b) and 10a-232(b), respectively, of the General Statutes. As of February 1, 2011, the principal amount of outstanding bonds, secured by special capital reserve funds, for the Connecticut Housing Finance Authority, the Connecticut Resources Recovery Authority, and the Connecticut Higher Education Supplemental Loan Authority totaled $3,795,500,000, $35,800,000, and $189,200,000, respectively.*

8. *The State of Connecticut is contingently liable to the Connecticut Health and Educational Facilities Authority for amounts needed annually to maintain debt service reserves for one year's principal and interest on those authority bonds used to finance projects at participating nursing homes or to finance dormitories or facilities for the provision of student housing at public and private institutions of higher education, in the event authority funds are insufficient to do so, as provided for in Section 10a-186a of the General Statutes. As of February 1, 2011, the principal amount of outstanding bonds secured by special capital reserve funds totaled some $265,300,000.*

9. *Pursuant to Section 10a-109g, subsection (i), of the General Statutes, the State of Connecticut is contingently liable to the University of Connecticut for amounts needed annually to maintain debt service reserves for one year's principal and interest on certain university bonds in the event university funds are insufficient to do so. As of February 1, 2011, the principal amount of outstanding bonds, secured by special capital reserve funds for the University totaled $0, as the related special capital reserve fund bonds were refunded during the 2010 fiscal year.*

10. *In accordance with the provisions of Special Act 01-1, as subsequently amended by Special Act 01-2 of the June Special Session, the State of Connecticut was authorized by Special Act to guarantee debt issued by the City of Waterbury in an amount not to exceed $100,000,000. As of February 1, 2011, the amount of the city's obligations guaranteed by special capital reserve funds totaled $35,300,000.*

11. *In accordance with the provisions of Special Act 67-381, as subsequently amended by Special Acts 73-95 and 90-28, $1,470,000 in bonds of the Southeastern Connecticut Water Authority are guaranteed by the state, as of February 1, 2011.*

CONDITION OF RECORDS

Findings:

In the 2003-2004 fiscal year the State of Connecticut implemented a new statewide accounting system, referred to as Core-CT. Core-CT provides an integrated business process covering requisition, purchasing, appropriations and commitment control, accounts payable, and cash disbursements; accounts receivable, and billing and cash receipts functions. It also provides personnel and payroll management and accounting, project costing and inventory and fixed asset reporting. Core-CT is the foundation of the state's general ledger accounting and reporting.

The Budget and Financial Analysis Division of the Office of the State Comptroller encountered significant difficulties implementing the Core-CT accounting system. Our audits covering the initial implementation of the Core-CT system reported significant deficiencies in the state's financial accounting and reporting that are now considered resolved. Our current report covers the corrective action implemented since March 2010, and addresses some deficiencies with state accounting policies or procedures that require corrective action.

State Accounting Manual Update to Reflect the Core-CT Environment:

Criteria: Section 3-112 of the General Statutes provides that the Comptroller shall "establish and maintain the accounts of the State government…prescribe the mode of keeping and rendering all public accounts of departments or agencies of the State and of institutions supported by the State or receiving State aid by appropriation from the General Assembly… prepare and issue effective accounting and payroll manuals for use by the various agencies of the State."

The *State Accounting Manual*, issued by the Office of the State Comptroller, originally provided a formal set of accounting policies and procedures, and established the definitions of authority and responsibility between state departments and agencies, and the Office of the State Comptroller.

Condition: Our audits of state financial operations for the fiscal years ended June 30, 2004, 2005, 2006, 2007, 2008 and 2009 have each disclosed certain deficiencies in the Core-CT system. All have noted that the Office of the State Comptroller has not provided user agencies with an updated version of its *State Accounting Manual.* At the time of our review (April 2011), we were able to review a draft manual that reflected the progress made. However, it has not yet been made available to system users. In addition, we noted that the chartfield section of the *State Accounting Manual* that is available on the Core-CT website had not been updated since 2006.

Effect: The failure to provide an updated State Accounting Manual has contributed to user errors and miscoded and misposted transactions and general user frustration in managing the complexities of the Core-CT system.

Cause: In prior reports the Office of the State Comptroller has responded to our recommendation by citing a lack of resources and competing priorities which prevented corrective action. It has also referred to the online information available in the Core-CT web site as an adequate alternative to an updated State Accounting Manual.

Recommendation: The Office of the State Comptroller should promptly complete and issue or publish its revision to the State Accounting Manual. (See Recommendation 1.)

Agency Response: "As you note, the updating of the State Accounting Manual (SAM) to reflect Core-CT implementation has presented significant resource challenges as other high priority tasks were implemented. These tasks included establishing and updating on-line financial policy and processing help functions for state agencies within the Core-CT software. However, a draft version of the updated SAM, to which your office was provided access, has been developed and is being reviewed and edited. We expect the new manual to be available for use in Fiscal Year 2012.

You state that certain chartfield information has not been updated on the Core-CT website; however, up-to-date chartfield coding is readily available in Core-CT through EPM queries and also through various production report functionality.

We disagree with the assertion that the absence of an updated SAM has contributed to agency processing errors in Core-CT. Agencies have an abundance of resources currently available to prevent system processing errors. For example, utilizing the on-line functionality of Core-CT, financial guidance has been communicated to agencies in the form of on-line job aids within each Core-CT accounting application categorized by the specific module (e.g. purchasing, accounts payable, billing, accounts receivable etc.). In addition, Comptroller's numbered memoranda and Core-CT communications update users with respect to any significant accounting or processing changes. Agencies also have access to a help desk as well as to on-site training and labs."

Reconciliation of Cash Accounts in the Core-CT System - Office of the State Treasurer:

Criteria: The state's Core-CT accounting system has the potential to perform automated bank reconciliations which would identify all outstanding items as to date and amount. It is the responsibility of the State Treasurer's Cash Management Division to research and resolve unidentified variances when reconciling the bank accounts.

Condition: During the audit of the State Treasurer's Cash Management Division, we noted the state's payroll bank account was not completely and accurately reconciled directly to the general ledger cash account in the Core-CT accounting system. This reconciliation was not conducted in a manner which resolves all variances between the bank records and the Core-CT accounting records. As of June 30, 2010, the total of unexplained variances in the payroll account was $540,119, with many of these items not identifiable.

Current manual reconciliation procedures used by the State Treasurer are not sufficient to identify and explain all variances in the payroll account. The Core-CT accounting system, as it was implemented, does not have the ability to identify cleared payroll checks. The monthly bank reconciliation report from Core-CT provides an end-of–the-month net change in account balance by state agency but does not provide detailed information on individual bank transactions.

The State Comptroller and other state agencies journalize recovery of payroll overpayments as adjustments in the payroll account in Core-CT. These adjustments are not cleared directly through the payroll bank account and daily downloads from the bank only reflect cash transactions that have been cleared.

Cause: State agencies deposit payroll overpayments or workers' compensation recoveries into one of the State Treasurer's main depository accounts. The agency is instructed to enter a journal in Core-CT system coded to a payroll recoveries account (50235) established by the Comptroller in April 2010. The agencies may not have journalized the reclassification of these deposits or the Comptroller may not have processed the entries to offset the agencies' adjusted entries in the payroll account. In addition, non-cash transactions from W-2 corrections have been entered into the payroll recoveries account.

We also found inconsistent processing of the data from the payroll check reversal (COP-9 Form) which is used to adjust the payroll account, the deductions and taxes related to the overpayment and the employee's balances in Core-CT. There is no internal control to ensure state agencies or the State Comptroller properly and promptly enter and process journals to reclassify these deposits on the payroll account ledger.

A past decision to not implement the Treasury module for the Core-CT system left the State Treasurer with a labor intensive and inefficient method of bank reconciliation.

Effect: The State Treasurer cannot accurately and completely reconcile the payroll account ledger balance to the bank statement with the current manual procedures due to the lack of sufficient information on net payroll adjustments and supporting details.

Errors in the recording of the adjustments made to the payroll account may not be detected in a timely manner if deposit information is not coded correctly in Core-CT by the agencies.

Recommendation: The Office of the State Comptroller should, with the Office of the State Treasurer, work to improve and provide automation of the cash reconciliation process in the Core-CT system. (See Recommendation 2.)

Agency Response: "The Comptroller's Office has worked closely with the Treasurer's Office to develop procedures to facilitate payroll cash reconciliation. As you explain, a new process for tracking payroll recoveries was implemented toward the end of Fiscal Year 2010. In addition, payroll adjustments are being closely monitored by both agencies to ensure that deposits are properly matched to payroll adjustment documentation and that entries are processed in a timely manner. These changes should provide significant support in reconciliation. The Comptroller's Office will continue to work closely with the Treasurer to ensure that the reconciliation of payroll cash is timely and accurate."

Federal-Aid Billing in the Core-CT System – Department of Transportation:

Criteria: An accounting system is designed to assemble, classify, record and report financial data. An accounting system needs to provide accurate information regarding the recording of the proper federal grant program number, the accounting of receivables pertaining to payroll overpayments and the billing of non-wage payroll costs to programs and projects.

The Office of Management and Budget (OMB) Circular A-87 includes factors affecting allowability of costs. For a cost to be allowable under federal awards, they must meet the following general criteria:

- Be allocable to federal awards under the provisions of OMB Circular A-87. A cost is allocable to a particular cost objective if the goods or services involved are chargeable or assignable to such cost objective in accordance with the relative benefits received.
- Be accorded consistent treatment. A cost may not be assigned to a federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the federal award as an indirect cost.
- Be adequately documented.

Condition: A review of Department of Transportation project billings by the Federal Highway Administration disclosed a flaw in the functionality of the Core-CT system. That audit found that the allocation of fringe benefit costs and employer payroll taxes charged to each project on the basis of employee wages does not reflect that certain non-wage costs paid as wages, such as travel reimbursements, are not attributable to the actual time the employee spent on the project.

This matter was first reported in our audit for the fiscal year ended June 30, 2009. Our current review has examined the corrective action implemented. We found that Oracle, provider of the software for the Core-CT system, has provided the state with different system fixes, none of which have been successful. At the time of our review (April 2011), a third system fix was being tested.

Effect: Costs that were fixed in relation to employee hours worked were erroneously allocated to extra overhead costs that were billed to federal-aid projects at the Department of Transportation. This condition does not only affect the Department of Transportation, but may affect all state agencies using the Core-CT system to charge projects or programs with non-wage personal service costs. We do not have an estimate as to the total costs involved.

Cause: The Core-CT system design did not allow for the proper cost allocation of miscellaneous payroll payments. Payroll fringe benefits and employer payroll taxes are allocated to projects based on the employee hours charged to the project, costs that are fixed in relation to employee hours worked, such as travel and medical and life insurance costs, are included in the same allocation.

Recommendation: The Office of the State Comptroller should address deficiencies in the Core-CT system internal controls that affect the cost allocation applied to non-wage payroll payments. (See Recommendation 3.)

Agency Response: "Due to a software aberration in the method of processing and allocating certain non-wage payroll payments such as travel reimbursements, fringe benefit recoveries are erroneously applied to grants based on these non-wage payments. The software provider has recommended various fixes, and one such approach is in testing at this writing. We are in communication with the Federal Highway Administration with respect to our efforts to resolve the problem. We are confident of a resolution in Fiscal Year 2012."

Our examination also found a deficiency in the *Comprehensive Annual Financial Report* that was not related to the Core-CT system.

Failure to Comply with Governmental Accounting Standards Board Statement #45:

Criteria: Governmental Accounting Standards Board (GASB) – Statement No. 45, regarding accounting and financial reporting for post-employment benefits other than pensions (OPEB), requires the state to obtain an analysis of the unfunded actuarial accrued liability of such post-retirement health care and life insurance benefits and to recognize the annual required contribution to fund that actuarial liability in its financial statements commencing with those for fiscal year ending June 30, 2008.

Statement No. 45 also requires actuarial valuations of pension or OPEB plans to be performed as of a date not more than two years prior to the date of financial statements in order for the results of the valuation to be reflected in those financial statements.

Condition: In December 2010, the state received an actuarial valuation as of April 1, 2008 with respect to the state's liability for post-retirement health care benefits (not including life insurance benefits) for persons covered under the State Employees Retirement System and other state retirement systems, excluding the Teachers' Retirement System. The December 2010 valuation indicates an OPEB actuarial accrued liability as of April 1, 2008 of $26.6 billion on an unfunded basis and $14.0 billion on a funded basis. The State Comptroller posted the 30-year annual amortization of an estimate of the actuarial liability or total State Employee OPEB liability of $4,150,866,000 to the CAFR.

Because of the April 1, 2008 valuation date, the April 2008 actuarial report does not reflect the impact of the 2009 retirement incentive program or the mandatory OPEB contribution of three percent of salary by certain employees implemented in 2009. The valuation occurred too late to take these changes into account. At the time of our review (April 2011), the State Comptroller was in the process of contracting to obtain a new actuarial valuation for the 2010-2011 fiscal year CAFR report.

Effect: Because the latest actuarial valuation with respect to the state's liability for post-retirement health care benefits for persons covered under the State Employees Retirement System was as of April 1, 2008 and not within such two-year period, required disclosures for the plan on funded status, funding progress, and actuarial methods and assumptions could not be included in Note 14 of the June 30, 2010 Basic Financial Statements or in the required Public Employee Retirement System Supplementary Information accompanying the Basic Financial Statements in the CAFR Report. Certain estimates were made to include the net OPEB obligation in the liabilities of the state's Basic Financial Statements.

Cause: The Comptroller's Healthcare Policy and Benefit Services Division did not contract to have the actuarial valuation of the state employees other post employment benefits in time to meet GASB requirements.

Recommendation: The State Comptroller should take the measures necessary to ensure that its Comprehensive Annual Financial Report contains all of the information required by Governmental Accounting Standards Board standards. (See Recommendation 4.)

Agency Response: "Information sought by policymakers studying long-term liabilities of the State required an initial valuation period of April 1st. This date was subsequently used as the valuation period for consistency and comparison purposes. However, we agree that this creates a variance of three months in the valuation date required under GASB #45 (June 30th required date). Future contracting for actuarial services should reflect the GASB requirements."

RECOMMENDATIONS

Status of Prior Audit Recommendations:

Office of the State Comptroller - State Financial Operations Audit Report -

Two recommendations were presented in our prior report. They are being restated in our current report as three recommendations. A list of the previous recommendations and their resolution are as follows:

1. The Office of the State Comptroller should promptly complete its revision of the *State Accounting Manual* - Our current examination found corrective action, including reviewing an on-line draft copy of the manual. We again recommend that the Office of the State Comptroller promptly complete and issue or publish its revision of the *State Accounting Manual*. (See Recommendation 1.)

2. The Office of the State Comptroller should address deficiencies in Core-CT system internal controls that affect user agency access to Core-CT bank account information, the posting of payroll account adjustments, and the cost allocation applied to non-wage payroll payments. It also should establish a receivable account for payroll overpayments - Our current examination found corrective action for user agency access to Core-CT bank account information has been made. However, the Core-CT system still does not provide for the State Treasurer to efficiently reconcile cash accounts. We also found that the Core-CT system has not been modified to eliminate the improper distribution of fringe benefits on non-reportable reimbursements. We are repeating the recommendations pertaining to those matters. (See Recommendations 2 and 3.)

Current Audit Recommendations:

1. The Office of the State Comptroller should promptly complete and issue or publish its **revision to the State Accounting Manual.**

Comment:

We found that the state's accounting and administrative personnel require updated documentation of state accounting policies and procedures due to changes that have resulted from the implementation of the Core-CT accounting system.

2. **The Office of the State Comptroller should, with the Office of the State Treasurer, work to improve and provide automation of the cash reconciliation process in the Core-CT system**.

   Comment:

   We found that the current system of bank reconciliation is inefficient and does not resolve all variances.

3. **The Office of the State Comptroller should address deficiencies in the Core-CT system internal controls that affect the cost allocation applied to non-wage payroll payments.**

   Comment:

   We found that the Core-CT system does not properly allocate payroll fringe benefits and employer payroll taxes to miscellaneous payroll payments charged to projects and grants.

4. **The Office of the State Comptroller** should take the measures necessary to ensure that its Comprehensive Annual Financial Report contains all of the information required by Governmental Accounting Standards Board standards.

   Comment:

   As a result of the failure to provide all the information required by the Governmental Accounting Standards Board, we were required to issue a qualified opinion on the 2010 fiscal year CAFR.

CONCLUSION

In conclusion, we wish to express our appreciation of the courtesies shown to our representatives during the course of our audit. The assistance and cooperation extended to them by the personnel of the State Comptroller's office in making their records readily available and in explaining transactions as required greatly facilitated the conduct of this examination.

Matthew Rugens
Administrative Auditor

Approved:

John C. Geragosian
Auditor of Public Accounts

Robert M. Ward
Auditor of Public Accounts